

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
A. H. COATES COMPANY }

Appearances:

For Appellant: Walter B. Lomax, Certified Public Accountant.

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise Tax Counsel.

O P I N I O N -

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of A. H. Coates Company to a proposed assessment of an additional tax in the amount of \$502.00 for the taxable year ended December 31, 1939.

Appellant, a California corporation, has acted for several years prior to 1938 as a manufacturer's representative, under numerous agency contracts with eastern manufacturers, including the Whitney Chain & Manufacturing Co. On July 31, 1938, that Company terminated the agency contract and distributorship of Appellant and cancelled \$16,000.00 of an indebtedness of \$17,431.09 due it by Appellant. In its return of income for 1938, Appellant reported a net loss of \$2,720.16 and paid the minimum tax of \$25. The Commissioner, however, determined that Appellant received income in the amount of \$16,000 by reason of the cancellation of the indebtedness and on the basis of that determination proposed the additional tax in question. Appellant objects to the Commissioner's action upon the ground that even after the cancellation its liabilities exceeded its assets.

Section 6(d) of the Bank and Corporation Franchise Tax Act provides, in part, as follows:

"If the indebtedness of a bank or corporation is cancelled or forgiven in whole or in part without payment, the amount so cancelled or forgiven shall constitute income to the extent the value of the property (including franchises) of the bank or corporation exceeds its liabilities immediately after the cancellation or forgiveness."

In support of its position, Appellant submitted a Trial

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Balance of its books as of July 31, 1938, reflecting adjustments to actual values of assets and liabilities after the forgiveness of indebtedness. In summarized form it shows the following:

ASSETS

Cash	\$ 818.95
Accounts Receivable	5,952.92
Inventory	2,404.26
Furniture & Fixtures	<u>250.00</u>
Total assets	\$9,426.13
Deficit	<u>17,670.56</u>
Total	<u>\$27,096.69</u>

LIABILITIES

Accounts Payable	\$9,420.94
Taxes Payable	<u>75.75</u>
Total liabilities	\$9,496.69
Capital Account	<u>17,600.00</u>
Total	<u>\$27,096.69</u>

The Commissioner concedes that Appellant's explanation for the adjustments in the value of its assets, as above noted, appears reasonable, but claims that the adjusted values have not been properly substantiated. He refers specifically to the reduction of furniture and fixtures from a book value of \$1,801.08 to an arbitrary figure of \$250.00, the elimination of a 1931 Essex automobile previously carried on the books at \$232.14, and the complete writing off of the asset "Agency Contracts" previously listed at \$10,102.36.

Appellant subsequently submitted a detailed schedule of the furniture and fixtures wherein a value of \$301.50 is ascribed to them.' That value appears to be reasonable, as does a value of \$50 for the 1931 Essex and \$5,952.92 for the accounts receivable. Very little evidence has been presented to us respecting the value of the agency contracts. It seems clear that they could not possibly have been worth the \$31,002.52 at which they were originally carried on the books on July 31, 1938. The Appellant first contended herein that they were without value, but subsequently suggested a value of \$5,877.37.*

*This value was obtained as follows:

Agency accounts carried on books at	\$31,002.52
Gross profit from agency account in 1937	24,101.65
" " " " " " 1939	<u>4,569.74</u>
Valuation of agency accounts after cancellations	

$$\begin{array}{r} \$31,002.52 \times \frac{4,569.74}{24,101.65} = \\ \hline 5,877.37 \end{array}$$

It has not in our opinion been established that the contracts were in fact of no value on July 31, 1938, and we are unable to accept the formula whereby the value of \$5,877.37 was obtained. The Commissioner has not objected to the writing down of the value of this item from \$31,002.52 to \$10,102.36, the contracts being carried **on** Appellant's books at the latter figure on December 31, 1938. Under the circumstances, we do not believe that we can on the basis of the record before us assign a value of less than that amount to them as of July 31, 1938. It may be noted that they were assigned this value of \$10,102.36 at the suggestion of an Internal Revenue Agent in 1940.

Valuation of assets July 31, 1938, as shown above	\$9,426.13
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Furniture & Fixtures, corrected	\$301.50	
reported	<u>250.00</u>	51.50
1931 Essex automobile-omitted		50.00

Total assets, as adjusted	19,629.99
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Excess of assets over liabilities	\$10,133.30
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ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of A. H. Coates Company to a proposed assessment of an additional franchise tax in the amount of \$502.00 for the taxable year ended December 31, 1939, be and the same is hereby modified as follows:

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turing Co, in the amount of \$16,000; in all other respects the said action of the Commissioner is hereby sustained.

Done at Sacramento, California, this 11th day of May, 1944,
by the State Board of Equalization,

R. E. Collins, Chairman
Wm. G. Bonelli, Member
Geo. R. Reilly, Member
Harry B. Riley, Member
J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary